

Issues Paper: Gas Services Information Allowable Revenue and Forecast Capital Expenditure for the Independent Market Operator

1 July 2013 to 30 June 2016

14 August 2013

Economic Regulation Authority

WESTERN AUSTRALIA

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1 Introduction

1.1 Background and Scope of this Issues Paper

Following the gas supply crisis caused by the Varanus Island incident in June 2008, the Gas Supply and Emergency Management Committee recommended the development of two key gas information services for Western Australia, including a Gas Bulletin Board (**GBB**) and a Gas Statement of Opportunities (**GSOO**).

The GBB and the GSOO are established by the *Gas Services Information Act 2012*, the *Gas Services Information Regulations 2012* and the *Gas Services Information Rules (GSI Rules)*.¹

Under the *Gas Services Information Act 2012*, the primary purpose of the GBB is to provide a website for the publishing of information about short or near term natural gas supply, transmission, storage and demand. It will also include an emergency management page to assist in the management of supply disruptions.

The purpose of the GSOO, an annual planning document, is to provide a comprehensive medium to long term outlook on natural gas supply, demand, transmission and storage capacity.

The objectives of the GBB and GSOO are to promote the long term interests of consumers of natural gas in relation to:

- the security, reliability and availability of the supply of natural gas in the State;
- the efficient operation and use of natural gas services in the State;
- the efficient investment in natural gas services in the State; and
- the facilitation of competition in the use of natural gas services in the State.

The Independent Market Operator (**IMO**) has been appointed to establish and operate the GBB and to prepare and publish the GSOO for the Western Australian natural gas sector. The first GSOO was published on 26 July 2013 and the GBB became operational on 1 August 2013.

Under clause 108(1)² of the GSI Rules, the Economic Regulation Authority (**Authority**) must determine the Allowable Revenue and Forecast Capital Expenditure for the IMO for each Review Period.³ This review covers the initial Review Period, commencing on 1 July 2013 and ending on 30 June 2016.

Pursuant to clause 109(3) of the GSI Rules, the Authority's determination must ensure that the Allowable Revenue and Forecast Capital Expenditure includes only those costs that would be incurred by a prudent provider of the relevant services, acting efficiently and seeking to achieve the lowest practicably sustainable cost of delivering those services.

Under clause 14(1)⁴ of the GSI Rules, the IMO is required to submit the initial Allowable Revenue and Forecast Capital Expenditure proposal to the Authority by 30 April 2013 or

¹ The *Gas Services Information Act 2012* commenced in April 2012. The *Gas Services Information Regulations 2012* and the *Gas Services Information Rules* took effect on 29 June 2013.

² Part 7, Division 2

³ Each Review Period covers a period of three financial years.

⁴ Schedule 3, Division 8

the first Business Day following the day that the GSI Rules commence, whichever is later. The IMO submitted this proposal to the Authority on 1 July 2013, following the commencement of the GSI Rules on 29 June 2013. This proposal is available on the Authority's [website](#).

Under clause 14(2) of the GSI Rules, the Authority must determine the Allowable Revenue and Forecast Capital Expenditure for the initial Review Period within four calendar months of receipt of the IMO's proposal, i.e. by 1 November 2013.

Under clauses 15(2) and 15(3)⁵ of the GSI Rules, the IMO must submit an initial GSI Budget Proposal to the Minister for Energy for approval for the 2013/14 financial year at the same time as the IMO submits its proposal for the initial Allowable Revenue and Forecast Capital Expenditure to the Authority. The GSI Budget Proposal must be consistent with the proposed Allowable Revenue and Forecast Capital Expenditure. This Budget Proposal, upon the approval by the Minister, will be used to calculate the GSI Fees for the 2013/14 financial year.

In determining the Allowable Revenue and Forecast Capital Expenditure for the IMO, under clause 108(3) of the GSI Rules, the Authority is required to undertake a public consultation process, which includes publishing an Issues Paper and issuing an invitation for public submissions.

The Authority has prepared this Issues Paper to assist interested parties in understanding the IMO's proposal and the Authority's approach and process, and in making submissions on these matters.

This Issues Paper addresses the following matters:

- The requirements of the GSI Rules for the determination of the IMO's Allowable Revenue and Forecast Capital Expenditure;
- Summary information on the proposal submitted by the IMO; and
- The process to be followed by the Authority in making the determination on the GSI Allowable Revenue and Forecast Capital Expenditure;

1.2 How to Make a Submission

A notice has been posted on the Authority's website advising of the release of this Issues Paper and inviting interested parties to make submissions in print and electronic form (where possible) on the IMO's GSI Allowable Revenue and Forecast Capital Expenditure proposal by **4:00 pm (WST) Wednesday, 11 September 2013**.

Submissions should be marked to the attention of Natalie Jackson and addressed to:

Determination of the GSI Allowable Revenue and Forecast Capital Expenditure for the IMO, 1 July 2013 to 30 June 2016 – Issues Paper.

Email address: publicsubmissions@erawa.com.au

Postal address: PO Box 8469, PERTH BC WA 6849

Office address: Level 4, Albert Facey House, 469 Wellington Street, Perth WA 6000

Fax: 61 8 6557 7999

⁵ Schedule 3, Division 9

CONFIDENTIALITY

In general, all submissions from interested parties will be treated as being in the public domain and placed on the Authority's website. Where an interested party wishes to make a submission in confidence, it should clearly indicate the parts of the submission for which confidentiality is claimed, and specify in reasonable detail the basis for the claim. Any claim of confidentiality will be considered in accordance with the provisions of section 55 of the *Economic Regulation Authority Act 2003*.

The publication of a submission on the Authority's website shall not be taken as indicating that the Authority has knowledge either actual or constructive of the contents of a particular submission and, in particular, whether the submission in whole or part contains information of a confidential nature and no duty of confidence will arise for the Authority.

1.3 Summary of Issues

Interested parties are invited to make a submission on the key assumptions employed by the IMO in deriving its proposed GSI Allowable Revenue for the initial Review Period, i.e. 2013/14 to 2015/16.

Interested parties are invited to make a submission on the IMO's capital requirements used in deriving the proposed GSI Forecast Capital Expenditure for the initial Review Period, i.e. 2013/14 to 2015/16.

Interested parties are invited to make a submission on the process that the Authority intends to follow in making a determination on the IMO's proposed GSI Allowable Revenue and Forecast Capital Expenditure for the initial Review Period, i.e. 2013/14 to 2015/16.

1.4 Requirements of the Gas Services Information Rules

Under clause 108(1)⁶ of the GSI Rules, the Authority is required to determine the Allowable Revenue and Forecast Capital Expenditure for the IMO for each Review Period, for the GSI services that they provide.

The GSI services required of the IMO are presented in clause 107⁷ of the GSI Rules. These services are:

- to establish, operate and maintain the GBB;
- to register or deregister Registered Participants and Registered Facilities and to grant Exemptions;
- to prepare and publish the GSOO;
- to make Amending Rules and Procedures, including the initial Rules made by the Minister under regulation 6 of the GSI Regulations;
- to facilitate the processes of the Gas Advisory Board;
- to monitor compliance and investigate breaches or possible breaches of the Rules or the Procedures;
- to take enforcement action under the GSI Regulations;
- to manage information gathering and disclosure functions under the GSI Regulations and the Rules; and
- services deriving from the exercise of any other functions conferred on the IMO under the GSI Act, the GSI Regulations or the Rules.

The matters for consideration by the Authority in determining the GSI Allowable Revenue and Forecast Capital Expenditure are presented in clause 109⁸ of the GSI Rules and are as follows:

- The Allowable Revenue must be sufficient to cover the forward looking costs of providing the GSI Services in accordance with the following principles:
 - a) recurring expenditure requirements and payments are recovered in the year of the expenditure;
 - b) capital expenditures are to be recovered through the depreciation and amortisation of the assets acquired by the capital expenditures in a manner that is consistent with generally accepted accounting principles; and
 - c) despite subrules (a) and (b), expenditure incurred, and depreciation and amortisation charged, in relation to any GSI Project are to be recovered over the period determined for that GSI Project.
- The Allowable Revenue and Forecast Capital Expenditure must include only costs which would be incurred by a prudent provider of the GSI Services, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering those services in accordance with the Rules, while effectively promoting the GSI Objectives.

⁶ Part 7, Division 2

⁷ Part 7, Division 1

⁸ Part 7, Division 2

- Where possible, the ERA should benchmark the Allowable Revenue and Forecast Capital Expenditure against the costs of providing similar services in other jurisdictions.

2 Independent Market Operator Proposal

2.1 Allocation of Costs across the IMO's Electricity and Gas Functions

With the appointment of the IMO to provide the new GBB and GSOO, the IMO now has two key areas of function, including:

- the IMO's existing electricity functions set out in the WEM Rules; and
- the IMO's new GSI services function set out in the GSI Rules.

As explained in its proposal, the IMO is integrating its new functions under the GSI Rules into its existing teams to enable it to achieve operational efficiencies that would not be achieved if the functions were operated separately.

Accordingly, many of the IMO's resources (including staff, administrative support, office accommodation, and other corporate and management support) will be shared across both functions. The IMO has developed a comprehensive cost allocation methodology to allocate these shared costs across its electricity and gas market functions. The IMO's proposed Allowable Revenue and Forecast Capital Expenditure for its WEM activities, for the third Review Period (2013/14 to 2015/16), included this cost allocation methodology and were approved by the Authority in March 2013. This determination is available on the Authority's [website](#).

2.2 Proposed GSI Allowable Revenue and Forecast Capital Expenditure 2013/14 to 2015/16

The IMO's proposed GSI Allowable Revenue and Forecast Capital Expenditure for the initial Review Period, 1 July 2013 to 30 June 2016, are presented in Table 1 below.

Table 1 IMO's Proposed GSI Allowable Revenue and Forecast Capital Expenditure for the Initial Review Period 2013/14 to 2015/16 (nominal \$'000)

Item	2013/14	2014/15	2015/16	Total
Allowable Revenue	2,250	2,360	2,309	6,919
Forecast Capital Expenditure	88	157	216	461

In its submission, the IMO has noted that its submission is made on the basis that:

- it covers the first three years of "business as usual" (**BAU**) operation of the new GSI Services;
- the IMO has had to estimate the resources required in delivering them; and
- the business requirements of Gas Market Participants and other stakeholders have an influence on the IMO's workload and subsequent expenditure.

2.3 Allowable Revenue

The IMO's proposal provides information on its proposed Allowable Revenue for each year of the initial Review Period as set out in the cost categories in Table 2 below. These categories are consistent with those in the IMO's proposed Allowable Revenue and Forecast Capital Expenditure for the 2013/14 to 2015/16 Review Period, for its functions required under the *Wholesale Electricity Market Rules (WEM Rules)*, submitted to the Authority for approval in November 2012.⁹

Table 2: IMO's proposed GSI Allowable Revenue for the Initial Review Period 2013/14 to 2015/16 (nominal \$'000)

Parameter	2013/14	2014/15	2015/16	Total
Employee Benefits Expense	798	761	793	2,352
Accommodation	103	99	103	304
Supplies and Services	629	727	628	1,985
Borrowing Costs	150	127	103	379
Depreciation	571	646	683	1,899
Total Expenditure	2,250	2,360	2,309	6,919
Interest Revenue	-	-	-	-
Allowable Revenue	2,250	2,360	2,309	6,919

The key assumptions employed in the derivation of the proposed Allowable Revenue for the initial Review Period are provided in Table 3 below.

Table 3: Key assumptions applied by the IMO in the derivation of Allowable Revenue for the Initial Review Period 2013/14 to 2015/16

Cost or Calculation Parameter	Key Assumption
Escalation Rate for Annual Indexation Costs	Indexation cost based on Department of Treasury advice of 1.75 per cent across the Review Period.
Employee Benefits Expense ¹⁰	There are no dedicated gas positions proposed for 2013/14 onwards as the IMO functions under the GSI rules and regulations will be integrated into the IMOs existing operations and will be delivered by IMO staff that have both electricity and gas related responsibilities. The IMO currently has 39 approved positions, corresponding to 38.5 FTEs after adjusting for part-time positions.

⁹ The Authority completed its determination on the IMO's Allowable Revenue and Forecast Capital Expenditure under the *Wholesale Electricity Market Rules* in March 2013. For more information, see [http://www.erawa.com.au/cproot_download/11259/2/Allowable%20Revenue%20Determination%20IMO%202013%2014%20to%202015%2016%20\(Final\).pdf](http://www.erawa.com.au/cproot_download/11259/2/Allowable%20Revenue%20Determination%20IMO%202013%2014%20to%202015%2016%20(Final).pdf)

¹⁰ Employee benefits expenses include such things as salaries, superannuation, payroll tax, fringe benefits tax and other staffing costs.

	<p>Five temporary positions (corresponding to 4.5 FTE) were approved for 2012/13 for the GISP, with three of these positions planned to transition into permanent positions from 2013/14.</p> <p>The IMO has determined that two additional positions (2 FTE's) are required in the Review period, including a Junior Lawyer and a Graduate.</p> <p>The combined effect of the three position transitions and the two additional positions result in the IMO having 44 positions from 2013/14, corresponding to 43 FTE after adjusting for part time positions. Increases in salary costs are based on considerations by the IMO Board of the history of recent salary increases for IMO staff, and the recommendations of base salary ranges for 18 specialised positions (e.g., market operators) provided by an independent remuneration consultant. The IMO reviews staff performance and recommends salary increases commensurate with performance, with effect from 1 April each year.</p> <p>The reduction in Employee Benefits Expense in 2014/15 reflects a higher allocation for Corporate Legal expenses in the year of services commencement (i.e., in 2013/14) than in subsequent years, whilst the increase again in 2015/16 results from standard cost escalations of the various Employee Benefit expenses.</p>
Supplies and Services	<p>The IMO relies strongly on the outsourcing of specialist services. System Planning costs are the costs associated with specialist forecasting services for the annual GSOO, and are expected to be highest in 2013/14 (\$120,000) as the IMO prepares its first complete GSOO, which will require forecasting processes and information gathering mechanisms to be established.</p> <p>The largest component of expenditure under IT Support is around \$95,000 per annum for GBB maintenance and development support.</p> <p>The largest component of expenditure under Corporate Support costs are those relating to accommodation i.e., around \$90,000 per annum.</p> <p>Market Administration costs in 2014/15 include the cost of undertaking a post implementation review of the costs and benefits of the GSI Services (\$100,000) that was requested by Market Participants.</p>
Depreciation	<p>A key component of this proposal is the recovery of the costs of implementing the GSI services. A budget estimate of \$2.965 million was developed in early 2012 and was funded by borrowings from the Western Australian Treasury Corporation (WATC) in July 2013.</p> <p>This loan funding will be capitalised at the end of the Gas Information Services Project (GISP) i.e., 31 July 2013 and together with depreciation that flows from assets purchased over the review period, will be recovered from gas market participants over the first five years of operation of these services, in accordance with the IMO's depreciation policy. If the full amount of the funding is not employed in the implementation of the GSI services, an adjustment will be made to reflect this in the Budget Proposal for the 2014/15 financial year.</p>
Borrowing Costs	<p>Projected borrowing costs across the Review Period have been calculated based on existing funding facilities and projected capital expenditure and are based on funding rates provided by the Western Australian Treasury Corporation.</p>

Interested parties are invited to make a submission on the key assumptions employed by the IMO in deriving its proposed GSI Allowable Revenue for the initial Review Period i.e., 2013/14 to 2015/16.

2.4 Forecast Capital Expenditure

The IMO's proposal provides a copy of its IT Roadmap, covering the period 2013 – 2016, which is the primary strategic planning tool used by the IMO to ensure that planning, delivery, management and use of the IT systems optimally support the IMO's business.

In its submission, the IMO noted that it submitted the IT Roadmap to the Minister for Energy for endorsement on 26 October 2012, for consideration as part of the State Capital Budget for 2013/14 onwards.

This is the third technology roadmap that the IMO has produced and is the first to include provision for the new GBB.

A summary of the capital requirements used in deriving the IMO's proposed GSI Forecast Capital Expenditure for the initial Review Period is presented in Table 4 below.

Table 4: IMO's Proposed GSI Forecast Capital Expenditure for the Initial Review Period 2013/14 to 2015/16 (nominal \$'000)¹¹

Item	2013/14	2014/15	2015/16	Total
Extensions ¹²	-	70	71	141
Development of Rule Changes ¹³	69	70	71	210
IT Hardware/Software Replacement (3 yr cycle)	-	-	50	50
Corporate Support ¹⁴ - Gas	19	17	23	59
Forecast Capital Expenditure	88	157	216	461

Interested parties are invited to make a submission on the IMO's capital requirements used in deriving the proposed GSI Forecast Capital Expenditure for the initial Review Period i.e., 2013/14 to 2015/16.

¹¹ Numbers may not add up due to rounding.

¹² The 'extensions' category includes a capital program to allow for enhancements (e.g., further integration in more established parts of IMO IT systems) identified post GISP.

¹³ This asset allocation supports the GBB Rule Change process, allowing for the technical implementation of Rule Changes as required.

¹⁴ Includes projects that directly support administration activities (e.g., maintaining phones, Microsoft Office, and accounting systems).

3 Process to be Followed by the Authority

As this is the initial Review Period for the determination of the IMO's GSI Allowable Revenue and Forecast Capital Expenditure, the process that the Authority intends to apply in its determination is to:

- Assess the proposal against benchmarks of the actual costs of parallel services provided by the IMO, in the WEM, where possible (e.g., the development of rule changes).
- Benchmark the costs of the GBB and GSOO against similar gas information services provided by the Australian Energy Market Operator, where possible.¹⁵
- Seek further supporting information for the proposed Allowable Revenue and Forecast Capital Expenditure sufficient to demonstrate that it is consistent with costs that would be incurred by a prudent provider of services, acting efficiently and seeking to achieve the lowest sustainable cost of delivering these services in Western Australia.
- Identify and assess whether recurring expenditure requirements and payments are recovered in the year of the expenditure.
- Assess whether amounts of depreciation and amortisation included in the Allowable Revenue have been appropriately determined from Capital Expenditure.

Interested parties are invited to make a submission on the process that the Authority intends to follow in making a determination on the IMO's proposed GSI Allowable Revenue and Forecast Capital Expenditure for the initial Review Period i.e., 2013/14 to 2015/16.

¹⁵ The Authority notes that in some instances it may not be practical to undertake such benchmarking as there are no directly comparable entities to the IMO in other jurisdictions in terms of scale of operation, structure of the business and nature of activities.